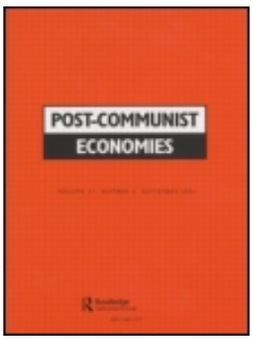

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Russia Beyond *Perestroika*

LÁSZLÓ CSABA

Communist Economies and Economic Transformation 1992.4:333-359.

It would require a lengthy book to analyse the ups and downs of the Soviet reform, its history of hopes, promises, failures and accomplishments. Since the constraints of time and space put severe limits on the truly scientific substantiation of individual statements, I have opted for a thesis-like elaboration. Each of my statements may be liable to criticism, more sophisticated formulations might be appropriate, and substantiations may be less convincing than scientific writings would normally require. However, topicality and the timespan may allow some relevant ideas.

First, the *perestroika* years have disproved the widespread belief that the system as such was everlasting. Changes in foreign policy, in the power structure, in the role of ideology, in socio-economic thinking, even in the norms of behaviour of most socio-economic actors, have been fundamental. These far exceed even those expectations that used to be regarded as the most radical among outside observers. True, even these modifications have proved insufficient to bring about a fundamental turn in Soviet economic processes. The overall rates of economic growth and the acceleration of technological progress, i.e. the key aspirations of the Five-Year-Plan, have suffered especially.[1] Moreover, such areas as foreign trade and the equilibrium on the domestic market have joined those that counted among the politically recognised problems. The nationality question, once declared non-existent by the introduction of the notion of the Soviet people (in the singular), has also proved to be an explosive area. Although the tensions did not stem primarily from the economy, and the eruption of the problem seems to be rather a consequence of decades of failure to face the legacy of the tsarist empire, these developments have had immediate repercussions on the functioning of the Soviet federal economy, rendering rather irrelevant its conventional descriptions as a single centralised workshop. The strike waves appearing primarily in the so-called strategic branches and chiefly in Russia proper since June 1989 have dramatically shown that the limits to power are far from being identical to those conceived and/or tolerated by the ruling strata.

This has a direct bearing on our subject, the economic system and economic policy. Namely, the limits and gross inadequacy of the approach predominant

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until recently, whereby artificially constructed models were to be imposed on the 'imperfect' reality, has become evident. In other words, one of the longstanding traditions of the European socialist movement, called in German *Sozialkonstruktivismus,* the idea that the 'ideal' society can and should be constructed in offices, and later implemented by the force of the state, has come into contradiction with Soviet realities. This development can be best traced through the rather fruitless debates about what an ideal, optimal or socially just price system should be under central planning. For obvious reasons no convincing answer can be given to the traditional questions, since they have been wrongly posed. The purpose of the price reform (see below) is not to create a 'good' or 'equitable' price system, but one that is able to transmit the billions of interconnected items of microeconomic information among those in the market, thereby enabling the equilibration of supply and demand in a continuous manner. This is the cornerstone of any market economy. And if one could hardly trace the recognition of this fundamental fact of life in Soviet economic writings some years ago, by 1990 it has developed into a politically represented idea.

This short introduction has already brought us to the heart of the seven years of *perestroika* processes: i.e. the large and ever growing duality between the breathtaking pace of theoretical, political and conceptual evolution in all walks of life, on the one hand, and the rather stagnant, on important occasions even radically deteriorating processes in reality on the other hand. This also implies that one of the incontestable success stories of the *perestroika* years was foreign policy, the other being *glasnost'* in practice. Meanwhile the Soviet Union has taken the initiative in all areas of international policy, finally overcoming its defensive, losing position of the 1980s.

Last but not least, the new concept of Soviet parliamentarism, despite some serious flaws in the first attempt at introducing limited and managed pluralism, has brought important results. By institutionalising the diversity of views and making them public, by introducing checks and balances to the previously hardly controlled executive power, the probability of correcting mistakes has increased and a powerful feedback to decision makers has been established. True, as economic debates have immediately shown, democracy means the freedom to say silly things but, as we also know, no one knows any better. In other words, Soviet parliamentarism certainly acted as a forceful safeguard of maintaining the *status quo* of socialist reforms and provided scope to fight against the vested interests wishing to sabotage any meaningful change. In other words, the Congress of People's Deputies was an institutionalisation of *perestroika* against the continuously present hardliners.

Institutionalisation of the reform seemed to have been a particularly important achievement, since *perestroika*—like the Hungarian reform—was meant to be a truly social transformation, a process of learning by doing. Therefore the issue of social feedback and controls seemed to be at least of equal importance to the congruence and adequacy of the reform project as such.

If at some point we reached a favourable overall assessment of Soviet reform policies, this was because our point of reference was the 35 years of reform deliberation in Poland and Hungary. In these cases it required decades until acceptance of some traditionally controversial ideas, such as the need for a real, self-regulating market rather than a simulated one, the inadequacy of mere greater reliance on the financial bureaucracy (while administrative,

Communist Economies and Economic Transformation 1992.4:333-359.

bureaucratic coordination of economic processes remained predominant), or the importance of capital markets and foreign economic opening, spread even among experts. In my reading of Soviet political and economic thinking about these issues,[2] it had made up for the losses caused by two decades of post-Stalinist stagnation by the late 1980s.

However, the ground that could be made up completely in theoretical development in a few years with relative ease could certainly not be matched in economic reality. In economic structures and performance past concepts and decisions were bound to exert long-lasting influences irrespective of current economic policy. The state of infrastructure, the aspirations and interest articulation of the state bureaucracy, the qualities, aspirations, time horizon and behavioural norms of small-scale entrepreneurs, as well as social expectations, including what is or is not considered equitable, form part and parcel of the 'factor endowments' of any reform policy. This held *a fortiori* for the Soviet Union, whose self-interpretation had been so intimately intertwined with the concept of the 'brave new world'.

Consequently, even if in 1985 the level of knowledge and aspirations had been identical with those expressed in the programme of the intra-regional group of deputies in December 1989, and even if such a programme had been politically feasible in 1985, the road to Soviet economic consolidation would have been bumpy indeed. But as is common knowledge, the two previous postulates do not hold. The development of the Soviet economic reform was one of evolutionary change. This time-consuming evolutionary process, starting from the technocratic concepts of 1985, to the radical proposal to introduce a real market economy with capital markets and convertible currency, is relatively well described in the programmatic document of the Governmental Committe on Economic Reform, published for discussion in October 1989.[3] Although political exigencies to a large extent explain the slow pace of change and especially the always more moderate and often formal implementation, explanation does not mitigate the repercussions of this state of affairs. To be more precise, the inherent belatedness and the conceptual unclarity coupled with the retarded and watered down implementation together were responsible for the overall crisis in the Soviet economy, especially in the consumer goods market.

Below I summarise my understanding of why the real situation deteriorated while the intellectual and conceptual processes made considerable advances. I then list those factors of supply and demand which determine the present disequilibrium. Finally, I put forward some arguments why only monetary reform and the concomitant radical marketisation could have improved the Soviet economic situation dramatically.

Let us first sum up the five major mistakes committed by the reform policies of the Gorbachev years.

Five Major Mistakes of *Perestroika* Economics

(1) The priority intention of *accelerating the rate of economic growth* proved to be a fundamental policy mistake. Acceleration in more general socio-political terms was, of course, a reflection of the newly emergent *perestroika* self-interpretation, tellingly formulating how the new policy differed from what

Communist Economies and Economic Transformation 1992.4:333-359.

used to be called 'mature socialism'. In these general terms it was certainly a progressive slogan. However, in socio-economic terms it proved to be a disaster.

(a) It raised unrealistic expectations of improvement, both in terms of living standards and technological and thus overall economic breakthrough, the conditions for which did not exist. The performance of the economy was more or less objectively conditioned for slow growth, but influential decision makers and the population have been measuring progress against artificially enhanced expectations. Thus disenchantment was much greater than objectively justified.

(b) As happened so often in previous socialist economic reforms, meeting quantitative plan targets took priority—not, of course, in reality, but in the behaviour of management organs. If it is quantity which matters, then quality, technological change and especially independent enterprise decisions are bound to remain in the background. To put it differently, expansionary policy in a planned economy leaves—for objective reasons—little room for enterprise autonomy, the scope of which tends to decrease in proportion to the efforts to increase overall rates of growth (and irrespective of the success of the endeavour). Major structural changes and acceleration of technological progress took place in Western countries as well in periods of recession or stagnation, and this is hardly by chance. First, old, outdated structures have to be eliminated, and time and capital are required for new activities to grow into internationally competitive ventures. In all experience, this process takes years, even under well-functioning market sytems.

(2) The role of finance has been neglected, despite the general statements made at the XXVII Congress. In my view this problem has two distinct sides. The first is the *quantitative* aspect, sufficiently described in Soviet economic literature in the context of the soaring budget deficit. The quantitative oversupply of money, its faster growth than the GDP, was partly due to inevitable social pressures thwarting the original intention to restrict the growth of wages below that of labour productivity. The larger part of unjustified money creation was, however, due to the continued fact of extending credit according to the plan, rather than according to criteria of return, which is an absolutely integral part of mandatory planning. Still, recurring policy statements of those responsible[4] indicated no willingness to give up this powerful role in exchange for what may have sounded like a vague promise of control by and through the ruble, where emission and management of the money supply are crucial. As long as creation of credit is linked to financing plans approved in physical indicators, and as long as deviations from the originally approved plans remain as common as they have been over the past 65 years in Soviet investment (both in terms of completion times and in terms of actual vs. planned performance, not to speak of actual vs. 'normative' costs) the inflationary overhang was bound to remain a lasting and inevitable feature of the Soviet economy. There is no need to elaborate why money created as credit for these illegal but widespread practices will never be recouped or syphoned off from circulation.

This brings us to the *qualitative* aspect of money. The role played by money in a mandatorily planned economy differs fundamentally from that in a market economy, which has immediate repercussions for practical policy making.[5] Among other things, it implies that decisions can not simply be decentralised in the very first phase of economic reform, as companies lack the compass for economically sound decision making. Prices in a mandatorily planned economy

Communist Economies and Economic Transformation 1992.4:333-359.

reflect, if anything, calculations and preferences of those who have planned at one point or another an investment decision, or decided income distribution, as well as *ex post* justification of actual production cost increases. In practice no one is in a position to establish, let alone to separate these factors, which appear in conjunction. In other words, actual prices reflect quite a few incidental things, but one thing they do not reflect is demand (scarcity). Even if they did reflect demand, they could not directly influence Soviet enterprises' ability and propensity to invest. Thus, the crucial constituent element of what makes market prices function was missing. Consequently, the systemic preconditions would first have had to be created for prices to make sense and function properly, and only then could they have been freed. As two German analysts noted,[6] this would have required conceptual clarity and political deliberation to a degree that was certainly not present in 1987–88. Freeing prices under such conditions—as suggested by many—would thus have been suicidal indeed. Without freeing prices, however, the pressure to recentralise by way of increasingly frequent interference by the authorities has proved inevitable. This was reflected, among other things, by the stubborn persistence of state orders, the maintenance of the material-technical supply system with all its pledges for preferential treatment (with the concomitant lack of a wholesale market) and the sheer growth of administrative and fiscal intervention (occasionally fuelled by the trade unions and part of the press).

(3) Despite manifold statements of intent to cut back *bureaucratic coordination,* in practice it remained predominant in all walks of life that are of importance for the economic system. This is not the place to document how in investment, in the organisational structure, in environmentally vital projects—be it positively or negatively—in industry and agriculture, as well as recently in the service sector too, bureaucratic decision making retained or regained the upper hand. The legislation of October 1989 limiting the activities of co-ops and tightening price controls actually closed the first serious loopholes created in the previously 'perfectly' integrated system of state-administrative controls.

True, as we have seen, the tendencies to recentralise were built into the actually existing Soviet mechanism of 1985–89. The propensity to maintain strict state control over any structure-forming decision was partly due to conceptual unclarities and partly due to the unintended side-effects of a half-reformed system without supply-and-demand (equilibrium) prices.

If the fundamental characteristics of the actually functioning system had not undergone any real change, there was objectively no reason to expect any improvement in Soviet economic performance. Rather, the continuation of the deteriorating performance of the first half of the 1980s was only to be expected, since there had been no single economic/systemic measure that could have been even meant to reverse the previous trend. I am deliberately vague about what 'performance' means in figures, as I do not intend to join the ongoing controversy in the CIS and abroad about the reliability and proper measurement of growth by Soviet statistics, but I do believe that no serious economist, familiar with Russian realities, would dispute the substance of the above evaluation.

(4) From the viewpoint of the evolution and maintenance of the dynamics of systemic change, it seems to have been a serious handicap for Soviet reforms that in 1986 and in 1989 again police, tax and other administrative restrictions

Communist Economies and Economic Transformation 1992.4:333-359.

on various non-state activities could be oberved. I mean the legislation on unearned incomes of May 1986, which was implemented with extreme zeal, and the limitation of the activities of the co-ops with effect from January and October 1989. However understandable the motives for passing these regulations may have sounded, objectively they have limited the evolution of truly market-type activities and behavioural norms in the USSR.

I do not belong to those[7] who consider the non-state sectors as the main field and standard of success for actual outcomes of reform policies in the planned economies. Still, I do believe the non-state sectors have been a rather crucial field, especially at the stage of launching the reforms. Briefly, from the point of view of the dynamics of change, both the supply and the demand side are of particular relevance. As far as the supply side is concerned, there is a lot of empirical and theoretical evidence from several reforming countries that the basically unreformed state-owned large-scale sector was bound to show a fair degree of inertia, as neither the stick nor the carrot created by a moderately reformed system appeared as particularly serious to them. On the other hand, the small-scale private and semi-private firms are normally composed of risk-taking, dynamic persons who really want to show quick results both for financial and prestige reasons. If they succeed, they provide an incentive to others to try, as well as empirical evidence of the enormous slack in the economy, that was usually disputed by those entrenched in bureaucratically overregulated systems. When the Hungarian intra-enterprise partnerships (VGMK) proved that productivity of labour could actually be increased by 50% under the same working conditions, without a penny of investment, merely by leaving out the unnecessary personnel and via better organisation of work, no one could continue to blame lack of investment for the unsatisfactory performance of large-scale state-owned industry.

Equally important is the resultant supply-side effect for the population at large. If people do experience tangible improvement in their lot thanks to the expansion of the new liberties brought about by the reforms, as they result in better supply of goods and services, popular support for the new course will increase. Tolerance and competence are two important requirements in this respect: income inequalities as well as prices are bound to grow, at least for some time. Competence is needed if this problem is to be overcome through increasing the number of new market entrants, i.e. by enforcing competition as well as introducing optimal rates of taxation.The latter implies taxes preventing exorbitant incomes without neutering the incentives to take risk.

It has to be clearly understood that these rewards have to be sufficiently high, especially in the initial years. Risking one's own property has to be accepted as a legitimate source of income both by legislation and the populace, otherwise speculation and sheer profiteering, i.e. the pre-capitalist forms of trade, will be bound to prevail. In the case of Hungary these two conditions were not met: the policy of grievances—the alleged discrimination against manual workers—and the campaign to force companies to produce cheap commodities proved to be instrumental in bringing about the first halt of the reform process in the early 1970s.[8]

Some parallels to these policies, as summed up in the governmental programme of December 1989, including the 'extraordinary measures to balance the consumer goods market', were obvious. It is also worth recalling that in China, where the opposite road had been taken, the supply of consumer goods

Communist Economies and Economic Transformation 1992.4:333-359.

expanded at a truly rapid pace. Although income inequalities did not, of course, decrease, the 1978–87 decade of Chinese reforms is universally seen as a success story, primarily for this very reason. The real turning point for the entire reform policy, however, comes not at the moment of equilibrating the consumer goods market but at a time private people begin to invest their money into companies, when profits from the non-state ventures start to be re-invested. It will not come overnight, and the more often the state harasses entrepreneurs through various means, the longer the pre-capitalist profiteering attitude and the resultant social apprehension will persist.

(5) Last but not least, the responsibility for the controversial outcome of the *perestroika* years rests with the gradualism in implementing changes. This option is politically always more appealing but less rewarding for the authorities. Half-hearted measures amidst widespread reform rhetoric are the best way to discredit correct ideas, as the ambiguous systemic environment provides a flood of concrete cases for those waiting for 'tangible' experience to prove the unfeasibility of the entire exercise. If a truly equilibrated consumer market still seems to be a remote eventuality for Russian citizens, in Vietnam the year 1989 alone sufficed to reach it.

Communist Economies and Economic Transformation 1992.4:333-359.

Supply and Demand

Let us first summarise the most relevant factors which determined the basic disequilibrium on the Soviet domestic market. As far as the supply side was concerned, agricultural performance has continually lagged behind plans, while the latter continued to be formulated on the basis of unduly optimistic assumptions. These have not been supported by appropriate policy measures, incentives or systemic changes, and the interest of the individual farmer hardly changed over the years. Production of industrial consumer goods and especially services of all sorts continued to be inadequate, whereas even temporary reliance on imports was rejected on traditional ideological grounds until the strikes of summer 1989 forced a reconsideration of this stance. The backward state of infrastructure as well as the inadequate motivation of the wholesale and retail network aggravated shortages. Finally, the fight against unearned income and restrictions on the co-ops deprived the state of a very efficient way of demand management.

Of course, the nature of factors shaping demand also played a role in widening rather than closing the gap on the Soviet consumer goods market. The wage system still reflected the Khrushchevian utopian–paternalistic approach, containing only some of those elements that Marx described as the reproduction costs of labour—expenditures on social security, housing, local transport (including cars) not to speak of savings for economic purposes or even less for purposes of productive investment. Therefore much of the effective demand absorbed in other industrial states by outlays for these activities, as well as tourism, as well as by the inevitable saving requirements for meeting these needs, appeared as monetary overhang on the food and consumer durable markets. The lack of private housing and of the system of lease-flats is also an important factor fuelling the growth of surplus money, despite significant open and hidden inflation in the *perestroika* years. Thus in my view *the structure of incomes* rather than the socio-politically determined wages increases remained

the underlying cause for the growth of the monetary overhang of the years of stagnation and also during the entire reform period.

It must be added that the nature of actual economic policy priorities in the years 1985–89 also contributed to the aggravation of this phenomenon. Since the politico-economic relevance of the consumer goods market as a key factor of the very feasibility of the entire *perestroika* process was not recognised until summer 1989, the actual emphasis was laid on modernisation of assets, rather than on closing the gap on the domestic market by gradually eliminating not only the monetary overhang but the causes for its persistence as well. Oddly enough, it was as if the good old Stalinist textbook law of demand inevitably exceeding supply 'under socialism' had remained the maxim in a period of radical politico-ideological renewal. It can be demonstrated even by the reproduction schemes of Marx that an emphasis on modernisation with fixed prices implied by definition an aggravation of shortages in the consumer goods market. Therefore, in retrospect, there can be no doubt that the policy of accelerating growth without fundamentally changing the economic system, i.e. the very technocratic concept, bears direct responsibility for the aggravation of those economic problems that posed a political threat to the entire *perestroika* in the early 1990s: the growing disequilibrium on the consumer goods market. True, it was not the sole factor to be blamed (as seen above), but it surely bears considerable responsibility.

Discussing this set of issues, a specific aspect of economic policy should be mentioned, which is not very frequently invoked while thinking about Russian economic policy: the factor of foreign economic relations. True, the *perestroika* years recorded significant and speedy progress from the initial concepts of technological self-reliance and economic invulnerability to the policies of long-term foreign economic opening, culminating in the prospect of what Shevardnadze described during his December 1989 visit to the NATO headquarters as the formation of a single integrated European economic space. Still, major reliance on imports of consumer goods, i.e. products in oversupply in the world markets, came only as a concession to political pressure, rather than as an element of a well-conceived overall strategy. It also deserves mention that the then Minister of Foreign Economic Relations, when explaining the new priorities, spoke about the need to increase Soviet exports by 2.5–3 times, without, however, uttering a word about imports.[9] This sounded a rather mercantilist approach to international trade. If, however, the parallel increase of imports was taken as given, the silence seems to me even more puzzling. In the course of radically reforming the entire economic system and changing the overall inward orientation of Soviet economic policies, the composition of imports was anything but irrelevant. Ritual reiteration of the need to import high-tech and nothing else could not be of much help.

In other words, it is the *function of foreign trade* which should have changed under any scenario. Given the structural weaknesses of Soviet exports, the continued low relative fuel prices, as well as the need for massive imports of consumer goods and intermediate products, the Soviet position in East–West trade has grown quite similar to what has been the lot of the smaller East European states, including the structural disequilibrium of the balance of payments. Since the East European countries have produced a rather variable menu of unsuccessful policies of adjustment to the world market in the last two decades, Soviet economists and policy makers could and should have saved a

Communist Economies and Economic Transformation 1992.4:333-359.

lot on learning by doing. It can be proved in detail[10] that the very weak correlation of domestic reforms to foreign economic policy, *the basically unchanged macroeconomic role played by external relations,* was very much to blame for the protracted crises in the small East European countries. Unless integrated into a conceptually coordinated reform strategy, foreign borrowing has been the best way to alleviate the pressures for systemic change, to provide a breathing space for the 'do nothing' policies that used to be so popular with the previous leaderships. After this stage, however, indebtedness turned into an independent barrier to systemic change, as it was seemingly always easier to order quantities to be exported than to wait for evolutionary processes of microeconomic adjustment to work through the economy. All the evidence is that by late 1991 reforming Russia had entered this stage.

After so many critical remarks it would still be a misunderstanding to conclude that Russian economic problems were absolutely insoluble, and the only conceivable future is a protracted crisis. It is often forgotten that several countries in the world have already faced similar problems, especially after the two world wars, but also some developing economies, and they did succeed in solving them. True, not without costs, but they succeeded. The therapy is implicit in the diagnosis sketched above.

As can be demonstrated through direct reasoning as well,[11] the clue to overcoming these strains and reversing the unfavourable trends could until late 1990 have been monetary and currency reform. As in Hungary and Germany after World War II, elimination of the monetary/inflationary overhang by an act of the state, the introduction of an independent monetary authority following very tight credit and money supply targets, allows the universal freeing of prices. Since after the reform it is money which is scarce, not commodities, new, scarcity-based relative prices will emerge, providing the millions of economic actors with the necessary and socially proper compass telling them what to do with their resources, where to invest, sell and buy. A marginal exchange rate could provide a second basic point of reference for the entire economy, showing where the margins of import-substitution and export-production respectively lie. If the capital market is allowed to operate, adjustment of production to the new relative prices will be comparatively fast and the recession needed for the adjustment will be relatively short. If an appropriate social safety net for the economically inactive is created from taxes that are not prohibitive to entrepreneurs, and state redistribution, as well as the state apparatus, is cut back to size, the cake—GDP—will grow. The growing cake allows for expanding welfare expenditure, thus in the medium run the economic operation will pay rather well in social terms too.

Communist Economies and Economic Transformation 1992.4:333-359.

An Abortive Attempt instead of Monetary Reform and Systemic Transformation: The Rise and Fall of the Shatalin Plan

The process of economic restructuring initiated by Gorbachev in spring 1985 was started as a conscious, planned and rather technocratic reorganisation of the traditional Soviet economic system. Its basic thrust was to serve the policy of accelerating growth (*uskorenie*), both the overall rate and in the field of technology in particular. True, with the passing of time a trend towards radicalisation become more and more pronounced. Still, the policy of *perestroika* remained—to use the Ligachev term—the socialist choice: a process which

was ready to sacrifice virtually any element of the previous regime in order to preserve the underlying construct. In other words, unlike the systemic change in Central European countries in 1989, *perestroika* never attempted to transcend and transform the system of state socialism. Instead, it was always an attempt to modernise it. However, like previous reform attempts in ex-socialist countries, *perestroika* set in motion processes and side-effects that have often proved to be the most relevant features of systemic change. The more or less unintended qualitative changes evolved in the course of 1989–90 on two different levels; that of national renaissance and of the re-emergence of civil society, as distinct from the formalised power structures of the state.

It would be unjustified to attribute the spread of national consciousness to the policy of *perestroika*, though *glasnost'*, i.e. the more or less open and widespread reporting of events has surely contributed to this phenomenon. Still, it is basically a historical legacy of tsarist Russia, the prison of nations, that the nationality issue has never been settled.

The much heralded internationalism merely attempted to camouflage and suppress fundamentally unresolved issues. As the erosion of central Soviet power become conspicuous, and the international policy context and the substantive features of new thinking made ruthless repression by force an exception to the rule, national awakening was only to be expected. What is relevant from our present, economic perspective is that political processes—like those following World War I or the collapse of the colonial system—do not follow any economic rationale. Rather, the value-rational political logic tends to superimpose itself over and above any 'rational' consideration, economic arguments included.

Thus the limited economic might of Estonia or the socio-economic backwardness of Tajikistan were not serious arguments against the inevitably unfolding processes of secession. The naive attempts to buy out the local elites only reinforced their self-awareness and fuelled further intransigence. If one might draw on the analogy of interwar Europe or the post-colonial third world in the 1950s and 1960s, economic nationalism, i.e. centralistic and *dirigiste,* and externally uncompromising policies were only to be expected from the seceding countries. This applies *a fortiori* to their neighbours and previous economic partners.

In operational terms it implies that June 1989 could have been the last historical moment to set up a new confederation—i.e. when Sakharov was booed for this proposition. A year and a half later any attempt to form a new treaty on federation was too little too late—open resistance in the Ukraine and in the Baltic states was a clear sign of it. By implication any plan taking the Soviet Union as a single unity—even the Shatalin Plan—was out of touch with the quickly emerging new realities. The Bill on Banking submitted to the Supreme Soviet in October 1990 was modelled more or less on the FED system of the USA—and this proved to be a problem. In the USA—at least since Abraham Lincoln—federal law is by definition superior to the law of each individual state. It was precisely this feature of Soviet legislation that had already been called into question by the respective declarations of sovereignty of the republics.

Introducing a national currency is not only a symbolic act—this is, at the end of the day, the only efficient way of sheltering a country from the dire consequences of the spillover of crises-phenomena in the federation. Unless

Communist Economies and Economic Transformation 1992.4:333-359.

immediate convertibility of the ruble were attained—which was impossible amidst the horsetrading over the ways stabilisation should be implemented—there was simply no alternative to separate national currencies. Thus the FED was not an appropriate model. Erection of internal customs barriers, not only by the Baltic countries but also by the Ukraine, Belorussia and *de facto* several major cities of the Union, was an accomplished fact in autumn 1990; thus the economic consequences of the political developments sketched above were immanent.

Let us add that this was far from the end of the road. Even if Democratic Russia remains on its own, it will continue to be composed of more than a hundred nationalities, among whom the Tatars and Bashkirs alone are more numerous than the Estonians. On the other hand, developments in Moldavia[12] clearly indicated that there must be a limit to the size of entities wanting to secede, no matter how arbitrarily this limit is set.

Turning to the other major level of developments, the qualitatively enhanced role of civil society has to be underlined. In a nutshell, if in the 1985–89 period the fundmentally absolutist nature of *perestroika* prevented its enlighted message getting through, from 1989 onwrds (especially since the summer strikes by miners) the erosion of absolutism, its structures and authority made its content and intentions irrelevant. The latter implies that traditional objects of Sovietology, such as the analysis of official documents, legislation and declarations of intent has become increasingly marginal in relation to the entire process.

In 1990 the continuous acceleration of the pace of changes become manifest. In the formal framework minor changes in the functioning of the economic mechanism, heated debates over the five-year plan and the target model to be implemented (i.e. non-existent issues), as well as the growing demonetisation of exchange were the most relevant features. Meanwhile, phenomena and issues traditionally discussed only as the irregular or underground economy expanded and grew in macroeconomic importance. The share of output delivered by co-ops in 1990 was put at 12–14% of GDP. With the shelves in the state shops empty, a growing share of demand was being met by items supplied on the official or unofficial free markets. As bureaucratic coordination was even strengthened by the very fact of demonetisation, by governmental actions allegedly defending the socially disadvantaged (such as sticking to fixed state prices) and by the campaigns against profiteering, the gap between increasingly liberal reform platforms and the ever more depressing economic reality grew wider than ever.

Against this background government talk about price 'reform', which had been going on for the third year, resulted obviously in further fuelling already substantial inflationary expectations.[13] By the same token the succession of new programmes proved more ephemeral than ever: according to the statement of thirteen rebellious economists in *Komsomol'skaya Pravda,* 4 November 1990, even the Shatalin Plan had become out of date before implementation. The uncontrolled and probably uncontrollable processes evolved with truly revolutionary speed.

Let us now summarise the five factors that made 1990 a turning point in Soviet development.

(1) As was illustrated by the speedy unification of Germany, the Soviet military threat ceased to be a credible policy-making factor. The dissolution of

Communist Economies and Economic Transformation 1992,4:333-359.

the Warsaw Pact was impending with the second strongest former member becoming an integral part of NATO. True, this dramatic rearrangement of postwar Europe was a precondition for Russia to become a candidate for the large-scale Western help and credit needed to overcome the crisis. Thus the policy of 'new thinking' embodied a vital interest of Russia.[14] Still, with the immediate military danger gone, the USA felt tempted to give in to the ever present isolationist tendencies, at least as far as (Eastern) Europe was concerned. This was also strengthened by the relocation of the global growth centre to the Pacific Basin. Moreover, with the technological revolution of the 1980s such traditional components of growth as raw materials, specifically coal and timber, which used to be the prime attraction in exploring Siberia, have lost their appeal. In other words, it will be difficult to find economic justification and interest in carrying out those large-scale projects in the Far East which used to be the main economic component of the *détente* of the early 1970s.

(2) Soviet parliamentarism, which used to play a progressive role in acting as a guarantee against Stalinist attempts to roll back reform processes, increasingly became an impediment to radical transformation. The Congress of People's Deputies, and even more the Supreme Soviet, reflected in its composition the balance of political forces in early 1989. By mid-1990 the standards had changed, and various vested interests tended to be overrepresented in these fora. The populous Central Asian republics, where even the 7 November parades went on as was usual under Brezhnev, the unions, the army and the party apparatus could together block any bold reform measure. Moreover, the sheer size of the Congress—over 2300 delegates—was such that its role could best be compared to the Constitutional Assembly convened after the 1905–07 revolution, i.e. a consulting rather than a decision-making body. All in all, the Congress blocked not only retrogression but also progression; furthermore, it was obviously unfit for making the resolute and quick decisions needed for crisis management.

(3) While Gorbachev managed to outmanoeuvre the party and rob it of its supreme decision-making position, he fell short of establishing an efficient presidential branch of power. The latter was still on the way to emerging; finally, no credible transmission belt emerged between the formally almighty centre and the millions of socio-economic actors. Therefore—paradoxically —*the actual decision-making freedom* of the state administration, i.e. of the much criticised bureaucracy, *increased rather than decreased* as a result of reforms. They exercised this power by way of interpreting and re-interpreting policy stances according to their own interest during the elaboration of detailed regulations. This situation, by the way, survived the demise of the Soviet state.

(4) If in the formal legislation 1990 was a year in which the Soviet Union made a giant step towards the *rule of law* (*Rechtstaatlichkeit*), the deadlock in political and economic decision making resulted in vesting exceptional powers in the hands of the President, who tended to rule his country in an autocratic manner. Though in principle these presidential prerogatives were meant to speed up the transformation from administrative to market economy, in practice it was difficult to justify the extraordinary arrangements. If one lists just a few among the first series of *ukazy,* defending the statues of Lenin, insisting on the 7 November parades, the compulsory surrender of foreign currency earned by enterprises to the centre, the instruction to meet contractual

Communist Economies and Economic Transformation 1992.4:333-359.

obligations made under completely different conditions, as well as the superimposition of eroded all-union legislation over national laws deserve mentioning. The last point seems to have embodied the fundamental paradox: by the time a full-fledged Franco-American type of presidential rule could have emerged, the federation which was to be ruled no longer held together.

(5) Last but not least, amidst political rivalry only one-sided programmes could be elaborated. On the one hand there was the politically credible but professionally poorly founded programme for 500 days,[15] whereas the technocrats around Abalkin worked out rather radical and well established models for partial areas such as enterprise management, without a clear-cut political platform or any credibility.[16] The integrated formula elaborated by Aganbegyan, the father of the concept of growth acceleration, heavily compromised the radical sounding general propositions. By further postponing radical action, reformist decision makers directly contributed to the escalation of the Soviet crisis.

To put it in a nutshell, the governmental programme followed traditional Soviet thinking in taking the state as the principal subject of economic processes. Therefore individual proposals aimed at improving the smooth functioning of an engine controlled from above. This was manifest in its keeping under central (traditional) control all areas which were considered to be the priority ones—such as investment, delivery of major foodstuffs, prices for politically sensitive commodities and relative incomes, leaving only 'secondary' areas and issues to the invisible hand. The Abalkin people were convinced of the merits of gradualism, as well as of the government's ability to find the appropriate dose of the bitter pills which society was still willing to swallow.[17] They believed strongly in the merits of indexation as the way the socially weak should be protected. The government proposals tried to eschew any issue which might have brought about ideological controversies, like privatisation or the decollectivisation of agriculture.

As a mirror image of the Abalkin group, radical economists elaborated a basically political programme for economic transformation. They did feature all the previous ideological taboos on the agenda, from cutting back the military–industrial complex to privatisation of land; however, they did not bother a lot about the details. In a way, they seem to have followed the Jeffrey Sachs approach of a big bang instinctively, where by definition it makes little sense to be too specific about the details following the bang.

This is not the place to go into the details of the international controversy about the vices and virtues of shock therapy *per se*.[18] The experience of the three Central European countries and Yugoslavia, however, should caution against an overdose of optimism as far as the speed of systemic transformation is concerned. Let us not forget: except for Czechoslovakia, these countries have been experimenting with marketising reforms for several years, so that thousands of economic actors—both in companies and in the administration—have already gained experience in market-type behaviour. Still, the years 1990–91 witnessed anything but a breakthrough. Furthermore, it seems that Russian reformers—like the ruling forces in Central Europe—failed to distinguish between issues of stabilisation and of systemic transformation. They seem to have believed that once the political obstacles to systemic change were overcome all tasks could be mastered at a stroke. The detailed deadlines in the 500-day programme about the measures to be taken at day X seem to reflect this rather naive belief.[19]

Communist Economies and Economic Transformation 1992.4:333-359.

In the Soviet Union, the command economy remained basically intact. Economic actors had no widespread experience with market behaviour. The social acceptance/legitimacy of the market distribution of incomes was rather limited, as the decision of the Russian Parliament of 14 November 1990 on further freezing prices indicated. Infrastructure that would be needed to conduct normal exchange between villages and towns is simply missing in many cases. Soviet peasants—especially in Russia proper—are poorly paid state employees, rather than farmers. The activity of traders organising economic circulation is often seen as parasitical or perversely profiteering. Thus the absorption capacity of the federation, even of an inflow of Western commodities, is much smaller than normally postulated.

Even if taken as a stabilisation package only, the 500-days programme may have fallen short of producing financial equilibrium. Most of the monetary overhang is not in the hands of the population, but is accumulated in the accounts of companies, or as unpaid or overdue debts to the banks. There was no way to get rid of this money short of currency reform or hyperinflation, though the course of events has already opted for the second solution.

Privatisation is a concept which is also easier to echo than to implement under Russian conditions. As is well known, the nationalisation of land was one of the first decrees after the October revolution, and thus it is hardly a surprise that Gorbachev insisted on a referendum on this issue rather than allowing privatisation. Even if El'tsin privatises land, that is hardly a solution after all those decades of state farming. First, a land reform, as in developing countries or after the abolition of serfdom in some countries, results in antiquated structures rather than in family farms along the West European lines. This kind of farming is extremely capital-intensive, and the assets of previous state farms are mostly unfit for a different kind of activity. Moreover, even if all 'technicalities' are addressed, it is questionable what proportion of assets could and indeed would be bought up by Russian citizens. Large-scale Western aid as a means for covering the imminent consumer goods shortage was not an integral part of the programme, though most political forces would certainly have welcomed it. The constitutional guarantees for private property and the elaborate legislation needed to create the environment in which it makes sense to accumulate capital rather than consume wealth was also not yet available. All in all, the interrelated issues, which could ideally be sequenced as monetary reform—equilibrating the consumer goods market (by Western assistance) and creating the constitutional guarantees for private property—institutional and organisational reform (abolition of sectoral organs and administrative monopolies), could have been the main tasks for *stabilisation,* which then could have been followed by a process of privatisation, lasting for several years.

In reality, the dangers of overdoing the radical reform programmes were anything but imminent. Finally, in November 1990 the *Aganbegyan version* of the integrated reform package was adopted. It took over the radical vocabulary and target setting from the Shatalin plan and all salient features of the original Abalkin–Ryzhkov plan. By opting for gradualism it opted for the instrumentalist approach, and in concrete terms for rewriting the price list first instead of syphoning off monetary overhang both from companies and from the population. This was truly suicidal under the conditions of shortages plus enormous monetary overhang. Once prices were declared to be flexible, they were bound

Communist Economies and Economic Transformation 1992.4:333-359.

to skyrocket under the direct impact of inflationary expectations, further fuelled by political uncertainty. As widescale indexation had already been promised, hyperinflation was bound to occur, much earlier than anyone expected. These concerns might only be repeated in the context of the economic programme of the Russian Federation first sketched by President El'tsin in October 1991. Once some prices were freed (with monopolies and other constituents of the soft budget constraint for companies remaining intact) others irresistibly followed.[20] There was virtually no measure to foster supply-side adjustment, and without letting the co-ops free and abolishing the compulsory deliveries in agriculture, coupled with privatising wholesale and retail trade, not even the spontaneous potential of the economy to adjust could be mobilised. Thus the crisis became deeper and longer than it otherwise need have been.

The most dangerous aspect of the Aganbegyan version of systemic change was that, for the public, opposing economic concepts were mixed up. Since under the radical vocabulary it tried to sell a poorly conceived effort to consolidate the old arrangements, it ended up in a paradox: popular expectations and legitimating principles, on the one hand, and elementary economic rationality on the other are often mutually exclusive. Thus whether military dictators or populist-unionist improvers of the world take governmental responsibility, they will find it difficult to adopt conventional economic rationality, so the foundation of their respective ruling structures remains shaky. This alternative can unfortunately be a rather lasting one, whatever is the interest of the local citizens and outside observers (including business executives).

It is worth recalling that this base variant of the forecast applies to Russia proper. In the 'periphery' rather divergent systems were bound to emerge: the Central European type of transition economies in the Baltic region, Georgia and Armenia, typical Islamic countries with Third World dilemmas in Central Asia, and most probably a Ukraine whose closest equivalent is the post-Ceausescu Romania or Serbia under Milosevic.

Thus, in summing up the period which can unmistakebly be called the 'Gorbachev era', it is difficult to share Roland's view[21] that it was only speed which was a problem for the Gorbachevian project, otherwise both strategy and sequencing were all right. Our description seems to have pointed in a different direction: neither a clear-cut strategy, nor a clear vision of the actual state of affairs, let alone their dynamics, and even less an ability to coordinate the things to be done and the ways to be taken could be attributed to the period when Gorbachev was more or less landlord of his own house.

From the Imperial Crisis Management of Pavlov to Reformist Disintegration under Silaev

The single year of 1991 was sufficient to illustrate the entire functioning of the political shuttle described above. In the first act, between November 1990 and August 1991, the military variant dominated; therefore it is only right if in the post-coup period the populist–nationalist variant dominated the scene. Meanwhile a multinational empire has undergone a cataclysm, which is only comparable to the disintegration of the Austro-Hungrian Monarchy in 1918. In retrospect there can be no doubt about the nature of Pavlovian economic

Communist Economies and Economic Transformation 1992.4:333-359.

policies as a reflection of imperial self-defence of the 'federal' bureaucracy. As documented above, *perestroika*, as an attempt at orderly reform from the top, came to end and economic realities evolved with ever increasing spontaneity. The federal bureaucracy, entrusted with continuous/daily crisis mangement, became terror-stricken that the increasingly radical reform projects openly questioned its *raison-d'être,* while they did little if anything to reverse the economic decay and political disintegration of a large multinational country. As seen above, the Shatalin Plan had not even come close to influencing legislation, let alone actual decision making. Still, this impracticable project did gain political legitimation for the idea of doing away with bureaucratic coordination as the basic method of managing economic activities. Meanwhile the national renaissance posed an immediate threat to the central power.

One of the options open to the decision makers would have been the adoption and implementation of a radical reformist line, implying a conscious rolling back of the state, both from civic society and the economy. The alternative option was to act as they actually did up until 19 August 1991. The central element in the latter was the attempt to retain control over all processes, bascially at any rate (in other words: the fear of spontaneous evolution of whatever sort). This induced fears and deeds, both becoming self-fulfilling. The cautiousness of Ryzhkov and Pavlov, as well as Gorbachev's clinging to the post of General Secretary, all reflected the fear of a sizable and *unforeseeable* rearrangement. In fact, they turned out to be ready to sacrifice virtually any constituent element of the traditional system, be it ideology or price stability, just to maintain the underlying fabric of traditional arrangements. For instance, few tend to remember these days that the idea of shock therapy was first elaborated by Yavlinsky in and for the Ryzhkov government, which—in fact—actually *supported* this idea in May 1990. They seem to have understood that this way they could have avoided open hyperinflation, thereby saving their power standing. Still, the majority of contemporary decision makers proved to be too short-sighted to adopt this line.

As we have seen in the previous section, the fight around the competing reform projects ended in an open power struggle. The 'empire struck back', and the President could survive the counter-attack of the old power structures by allying himself with them wholeheartedly. This was illustrated by his getting rid of reformist people and ideas from October 1990 onwards, by appointing an arch-conservative bureaucrat to the federal Premiership, as well as by the bloodshed in Vilnius and Riga in January 1991. The exemplary official, Pavlov must have earnestly believed he was actually governing a large empire, in which law and order could and should rule provided some of the penitent pupils were taught a lesson.

Meanwhile, El'tsin allied himself with the rebellious republics by supporting their claims *vis-à-vis* the centre. Gorbachev, for his part, countered by playing off nationalities without their own 'state' against the largest rebel republic. This game resulted in economic problems becoming manifestly secondary compared with redesigning 'national' territories and redistributing political power along these new lines. This was certainly an outcome which neither President intended, but neither was in a position to reverse the trend, whatever their concerns and deliberations may have been.

The rather spontaneous acceleration of events following their own dynamics is well illustrated by what happened in March–April 1991. While Gorbachev

Communist Economies and Economic Transformation 1992.4:333-359.

won a referendum favouring a federal Soviet state by a solid majority, only a few weeks later in Novo-Ogarevo he was forced to accept a compromise questioning both Russian supremacy and the foundations of the entire political system he himself created. The Supreme Soviet was not slow in pinpointing openly its disapproval of the President's circumvention of the constitutional arrangements.[22] True, at the time of his signing the Novo-Ogarevo pact, Gorbachev could not have been very serious about it, as such 'junior' members of his team as the federal Prime Minister or the heads of the KGB and the army openly disapproved of any weakening of central, federal control. But like Lenin's declaration of peace,what was meant to be a transitory concession turned out to be a fundamental point of reference for the opposing side.

The Novo-Ogarevo compromise was imposed upon the centre by the growing signs of manifest decay: triple-digit inflation following the monetary 'reform' measures of January 1991, the deepening recession and, above all, the disintegration of the central budget. While inflows collapsed, spending on the military and on administration, but also on 'structurally important' large investment projects, went on uninterrupted. All in all, each unit of government revenue tended to be spent twice: once in the republics and once by the Moscow authorities.

There were two alternative ways of reacting to these worrying signs. One was the Pavlov option: requiring exceptional powers to introduce a sort of martial law in the economy, or to create the dictatorship of central fiscal and monetary organs over companies and republics alike.[23] It is no coincidence that the underlying governmental anti-crisis plan was elaborated just at the time of Novo-Ogarevo and the concomitant discussion of the 'Grand Bargain',[24] i.e. the promise of tens of billions of dollars of Western aid for radical marketising reforms, implemented at the all-union level.

The alternative option was that of the rather hidden better half of the President agreeing to a substantial cutback not only of the powers of central organs in general, but also of his own presidential prerogatives in particular. As noted above, at the time of signing there was precious little indication of actual deeds and legislative acts that could have supported the seriousness of this more realistic approach.

It has become obvious by now that Pavlov and the military–industrial complex made a *temporary tactical concession* on Novo-Ogarevo and the reform plans, as they could not not resist the temptation of the tens of billions of dollars. True, Pavlov and Kryuchkov reiterated publicly the thesis that 'socialism will hardly be built on the money of capitalists', but they were unwilling to take the blame for refusal of the external money injection into the ailing Soviet economy. And in London the West was willing to discuss, indeed, a 'reform' package hand-made by Pavlov and his colleagues, with Yavlinsky not even invited to the final stages of preparatory work (let alone presenting his reform package to the G7). Still, from their perspective, Gorbachev returned empty handed from London, and the conservative, sceptical notes of Pavlov seem to have received a direct feedback.

It must have been a direct challenge to Pavlov and company that the President left for the Crimea *without having either brought money or provided them with the extraordinary powers* their anti-crisis plan would have required. Unless they wanted to accept the role of the 'incompetent officials' who are normally to blame for lack of improvement at the end of the year, it was

Communist Economies and Economic Transformation 1992.4:333-359.

imperative for them to act. The statistics for the first half of 1991 contained an all too obvious message.

There is no reason for us to doubt that the former Premier and his associates earnestly believed they were saving 1000-year-old Russia and socialism by trying to overthrow Gorbachev. It has been pointed out on countless occasions that though *perestroika* fell short of bringing about civic society and market regulation in the European sense of these terms, it did abolish traditional Russia, where strong state administration and chaos were the only alternatives. Pavlov and his associates fundamentally misunderstood current Russian realities. It is not only the 7–8 million strong class of quasi-private entrepreneurs who matter. As a consequence of the ongoing *nomenklatura* privatisation there are hundreds of thousands of party and state officials, municipalities, maffias and even substantial parts of the army who constitute an organised force, a vested interest in the evolving market order.[25] Unlike in 1968 in Czecho-Slovakia and in Hungary, most of the bureaucracy and the ruling classes were no longer threatened by the transition to the market, but had a stake in it. Meanwhile, for the Pavlovian anti-crisis plan there was neither a stick nor a carrot available any more.

On the other hand, despite the elimination of traditional imperial centralists as a force from the political scene, the road is far from being easy and open to market-type reforms. All the problems created by previous indecision in systemic terms and mistaken priorities in policy terms have been left behind. In other words, the Russian economy remains on the path of secular recession (conditioned by structural, systemic and foreign economic factors, to which political chaos and government decisions may only add). Inflation, too, was bound to develop into hyperinflation with all its consequences. Thus the Gaidar team *faced rather than caused this state of affairs* by freeing prices on 1 January 1992. The most serious handicap for the democratic government was the memory of the January 1991 ruble note confiscation measure and the *de facto* freezing of citizens' savings. As a consequence, monetary reform as the simplest way of eliminating the monetary overhang is out of the question for any elected government.

If for no other reason, owing to the natural reaction to the intensified and irreversible disintegration of a historical state-construct, administrative reflexes and reminiscences of how to run the economy have immediately come to the surface. As one of its first decrees,the operative economic committee of I. Silaev ordered workers, students and all sorts of urban dwellers to harvest crops (only a year after this measure was abolished under Ryzhkov). National governments, for their part, started their economic legislation by erecting internal customs barriers prohibiting all 'exports' to neighbouring republics, expanding national fiscal bureaucracies' control over anything conceivable, which was only one step from introducing their own national, inconvertible currencies: a step to be taken in weeks rather than months. The latter was justified not only by the emotional lure of national symbols, but also by the very real fear of the spillover effects of 'federal' crisis phenomena, primarily of the monetary overhang.

This state of affairs has had a number of repercussions. First, the Soviet economy, described even by the IMF and World Bank experts as a unified economic region in late 1990,[26] now belongs to history. Whatever the merits of the Yavlinsky plan of economic union were in September 1991, it is no wonder

Communist Economies and Economic Transformation 1992.4:333-359.

that a month later Russia and the Ukraine voiced very strong second thoughts about a strong central monetary authority following a joint/supranational monetary policy over which the republics would have limited if any control. In the processes of disintegration exacerbated by recession, the extent of which was estimated at 15% of GDP in 1991, the central bank could hardly know how much money should be emitted. Recession and fighting inflation as a *conditio sine qua non* for any economic rationality would have required a very tight monetary policy.

Meanwhile, political processes in general and the populist policies/heritage of the Russian Federation, which were elaborated in defiance of the Pavlovian restrictions, were all conducive to extreme monetary laxity. Thus, the increasingly unreliable monetary processes added to the ongoing processes of demonetisation—i.e. the spread of barter and payment in convertible currency. All this implied a growth in bureaucratic interference and regulation in daily economic affairs, whatever general pledges favouring the free market were being uttered by the political leaders. This and the political process of secession mutually reinforced each other, narrowing the scope for mutually advantageous trade flows. Thus, at the bottom line, there remains very little to make us believe that bureaucratic coordination could indeed be cut back and market coordination be extended in the post-Soviet economic space. Therefore both anchors of the Grand Bargain seem to be missing for a longer period of time.

Communist Economies and Economic Transformation 1992.4:333-359.

Epilogue

At the time of writing there was nothing as yet certain about the salient features of the new confederation which took the place of the one-time superpower. Issues of membership, delineation of powers and therefore such truly fundamental constituents of the economic system as the structure of banking, taxation and the future of interrepublican ties, and the way inherited Soviet debt was to be serviced, were yet to be clarified. Moreover, it was not only a fight about devolution of powers to previously existing entities but also about redefining the rights and even the structure and nature of political representation of nationalities traditionally having lived under the Russian state. Therefore the analogy with the disintegration of the Austro-Hungarian monarchy seems to be instructive. As Czecho-Slovakia or Yugoslavia did not have historical predecessors, Tatarstan and the Chechen or the Bashkir Republic may well develop different political qualities which will have immediate economic repercussions (suffice to recall the territorial location of available oil reserves).

One of the worrying features of the anti-crisis programme of the Russian Federation, promulgated by President El'tsin on 28 October 1991, was its overlooking of this fundamental circumstance and acting as if at least Russia could and should still be treated as a single economic (and by implication political) entity. It seems rather questionable what chances of implementation any project of this sort stands.

Therefore in this section I offer a rather speculative outline about what is and is not a feasible future economic system and policy in democratic Russia. Analysis of the proliferating new projects must be left to further studies.

With the *coup d'état* the policy of saving the military–industrial complex at any rate suffered a heavy blow. Therefore, the conversion plans that in the Gorbachev years were often announced but poorly if at all implemented[27] this time stood a good chance for being put into practice. The collapse of the empire has made a heavy industry originally cut to the shape of a superpower absurd and disproportionate, so the need to implement conversion is urgent. This also means that the previous priorities of planning, which distributed scarce resources contrary to considerations of optimal use (i.e. to the branches producing the least return) had to come to an end. This does not imply, however, that the shortage economy nature of the post-Soviet system can automatically disappear and hard budget constraints for enterprises will be introduced. The latter is a long way away—this is the general experience of all transforming economies. However, the previous 'principle' of necessary priority for inefficient heavy industries and the 'exigency' of neglecting infrastructure is no longer an external (political) constraint on Russian economic policy.

The collapse of the communist party and the related ideological taboos has paved the way for eliminating the *kolkhoz* system and the concomitant rural bureaucracy.[28] Still, it would be naive and positively dangerous to abtract from the entire heritage of the Russian peasantry and assume that masses of enterprising farmers are waiting impatiently for their land to be restored to them. On the contrary, Russia never knew wide-scale private ownership and individual use of land; moreover, collectivised agriculture has left a stratum of demoralised, disinterested and elderly rural population living in a Third World level of infrastructural environment. Thus the soil for wide-scale privatisation concepts has been anything but ready, whereas the imminent need to organise a minimum level of supply for the towns may legitimate the existence of the system of compulsory deliveries to the state. Furthermore, in Russia there is a lack of that farming tradition and entrepreneurial spirit on which Chinese and Hungarian agrarian reforms could be built. Therefore it would be premature to infer far-reaching conclusions from the fact that the President supports private ownership of land instead of leasing. As we have seen, much more mighty factors than communist ideology alone put very tight limits on rural privatisation in Russia. And we have not yet spoken of the absence of the monetary, credit and servicing infrastructure which is characteristic for modern West European farming. Thus both in terms of systemic change and of actual improvement of performance there is a long and toilsome march awaiting Russian agriculture.

Capitalism has gained momentum with the spread of commercial and banking activities all across the globe. It is well known that the moral and social disapproval of high profits, as well as the nature of these activities (commonly seen as parasitical), dates back well before the Bolshevik period in Russia. This and the development pattern of the last decades together left this nerve-system of the market economy in a very backward state. The recurring campaigns against speculation could be counted among the few truly popular actions of the *perestroika* period. Therefore there is every indication to believe that opening the door wide for these activities, especially if they are to be basically private, could only be a protracted and controversial process. This applies *a fortiori* for foreign banking.

The state of affairs sketched above reflects one of the fundamental contradictions of the coming years. Whereas most Russian democrats and economists

Communist Economies and Economic Transformation 1992.4:333-359.

pay lip service to the free market, the vast majority of the population considers only labour-related income legitimate, and disapproves of capital income. Harassment of 'speculators' of all sorts has been a constant feature of the last decades, which has only intensified the dominant pre-capitalist features of any private venture. Intimate relations, even intertwining with the mafias have become a precondition of survival for many of them. This has set back the social legitimation of wealth and *capital related income* even further.[29] Therefore ideological misgivings, even public outcry against *nomenklatura* privatisation is no less than in Poland or in Romania. This is a truly social constraint which is not to be overcome by a political turn alone. No wonder that even in the economics profession, trained over decades of anti-market traditions, knowledge of the market economy and its institutions and the techniques of applying certain arrangements is even more limited than in Central and South-Eastern Europe. Acceptance of these is even less. Thus, as is well known from World Bank experience in developing nations, *limits of human capital* may become an additional factor constraining systemic change. The availability of a few truly excellent analysts makes the contrast even stronger.

As privatisation and a fully-fledged market have been seen as diabolical up until 1990, it is no wonder that issues of systemic transformation are also inadequately elaborated in theory. As N. Petrakov noted[30] in a round-table discussion, the democratic opposition has fallen short of elaborating an alternative programme of economic governance, which could indeed be implemented once they got into power. The 500-days programme and others sufficed to express their deep disagreement with the tinkering of the (changing) teams around Gorbachev, but were a far cry from an operational economic strategy. This leaves the way open for economic messianism of various colours, and the public susceptible to quick fixes. In June 1991 the Russian parliament adopted a scheme of free distribution of shares in a country where investing your private money is one of the obviously foolish things you can do. The El'tsin programme of October 1991 envisaged the liberation of prices while Western assistance to stabilise the consumer goods market was anything but definite, and preconditions of a tight monetary policy were absolutely non-existent (owing—among other things—to the political turmoil and the indexation of incomes adopted by the same parliament only a few days earlier).

All in all, it seems hardly a coincidence that such technocratic economic liberals as Boris Fedorov or Grigorii Yavlinsky never gained a sound footing in the government of the Russian Federation. Meanwhile, such populist figures as Vice President Rutskoi, Parliamentary President Khazbullatov, Deputy Shakhrai or State Secretary Burbulis seem to have been having the ear of the Russian President over a longer period of time. Whatever the rationale or even the political justification for this state of affairs may be, one thing is certain: economic decisions will continue to be made on political grounds in this political context and not *vice versa,* as sometimes proposed by naive outsiders.

Therefore the underlying construct of the new political power sketched above, as well as the fight centering around the shape and structure of the new Russian state and its constituents and neighbours, make up the framework for economic transformation. There is little reason to believe that the popular idea of *razgosudarstvlenie,* deetatisation, could form the backbone of economic policies all across the CIS. Economic nationalism in the peripheries will only

Communist Economies and Economic Transformation 1992.4:333-359.

strengthen the already strong *étatist* traditions. As the market is distorted, with hyperinflation and mass impoverishment imminently dominating the scene, there is very little probability of accelerated transition to the market economy according to standard IMF prescriptions. The scene rather resembles Latin America, with political legitimation and economic common sense deeply separated at both ends of the political spectrum. Being at the populist end—despite the already widely anticipated threat from the militarist end—the following scenario seems to be probable.

As a reaction to widespread market imperfections the *state* will tend to interfere more rather than less in the affairs of business. Owing to the political risk and economic chaos, foreign direct investors will show at best a limited interest in buying up Russian state firms. With the very low level of domestic savings, coupled with obvious disincentives to economic investment (vs. keeping your money in hard currency or gold), privatisation is bound to remain very slow even if intellectual and political obstacles were quickly overcome. Therefore macroeconomic performance will be determined by the ailing state sector. Thanks to indexation and politically determined overspending, with a weak central monetary authority and lax taxation morality, inflation seems set to remain a lasting bedfellow of Russian democracy. With such a soft policy on the domestic front, all experience—especially of Latin America—would indicate a restrictive, administered rather than liberalised foreign trade regime.[31] Currency convertibility is incongruous with everything we have discussed above.

All this might imply that if the small privatisation could go on, if large scale Western assistance materialises and is made use of professionally, if emergence of market structures is not seriously impeded by state policies, and inflation slowed down, the quality of life might well improve in Russia. Still, the situation where the size of the Russian market—reflected in export earnings—is about twice that of Hungary will hardly change. Marginalisation in the world economy will be a lasting trend of Russian development.

Afterword

The first months of the Gaidar programme have by and large been supportive of our overall speculation in the Epilogue, originating from late autumn 1991. On the one hand, one of the boldest ever westernising–modernising endeavours in Russian economic history has been undertaken by the group of young liberals around El'tsin. The stabilisation shock has been delivered, with most prices freed, the freedom of economic activity and contracting has been institutionalised, plans for 'instantaneous' convertibility and mass privatisation have been promulgated by the government. Russia has been admitted to the IMF and the G7 has envisaged an immediate financial commitment of $24 billion, with another $40–50 billion assistance package seriously contemplated in the decision-making circles of the international financial community.

Meanwhile, the continuity of the *perestroika* period seems to shape actual outcomes more than the radical new projects. Gorbachev's legacy has outlived the master: the sixth Congress of the People's Deputies of the Russian Federation has resulted in a stalemate in April 1992 which most resembles the

Communist Economies and Economic Transformation 1992.4:333-359.

situation of October 1990. In other words, politicians survived while policies have suffered.

As in October 1990, the supra-parliament created by Gorbachev to avert retrogression again averted progress as well, since it reflects the balance of forces of 1989, not mid-1992. Owing to the over-representation of vested interests typical of the *ancien régime,* first the Soviet and now the Russian congress proved unable to institutionalise those reforms that would otherwise have resulted from a series of occasional and improvised measures and political evolution. In April 1992 the great victory for El'tsin was his ability to retain the Gaidar team, rather than getting the constitutional guarantees needed for the stable evolution of a free economy. This, in both cases, should be seen as an inevitable outcome stemming from its very nature rather than as an aberration of an otherwise healthy process.

As Soviet parliamentarism has always been an institutionalisation of the state-socialist *status quo,* rather than a democratic representation of a pluralist society, it is small wonder that these organs proved unable and unwilling to provide a framework for a fundamental transformation of the underlying construct, instead of its piecemeal reform.

In concrete terms, the sixth Congress of Russian Deputies has practically outlawed El'tsin's February decree on the compulsory dissolution or corporatisation of *kolkhozy* and prohibited the free selling and buying of arable land. As we saw with Gorbachev, this was hardly by chance. Conversely, from the perspective of an emerging free economy, fundamental proprietory rights have been withdrawn by the Parliament's defence of the 'socialist accomplishments' of the Brezhnev Constitution.

Like the earlier Hungarian halt in the reform process in 1969 and 1972, the political-level decision was only a visible culmination point of the undercurrent of retrogression, which had been well under way in the preceding months. In the case of Russia, price controls were not, in fact abolished at the time of the 'shock'. On the contrary, in the form of a governmental committee, *Goskomtsen,* the infamous price authority has been reestablished with wide-ranging powers to control the profitability (!) of products.[32] In January 1992 the President made several speeches indicating that no enforced privatisation lay ahead in large-scale industry, whereas the system of compulsory deliveries and *prodnalog* were to 'secure' the supply of cities with basic staples. The universal right to deal in anything anywhere, which did produce a remarkable supply response in the first quarter in towns, has been restricted by the City Council of Moscow from 1 May on public health grounds.

It is also a sign of continuity that government projects hardly affect actual changes in ownership, where spontaneous or *nomenklatura* privatisation prevails. One of the first major setbacks for the new economic team was the virtual halt of the proposed quick small privatisation in Moscow. Similarly, while the government planned to privatise 60% of all state assets by 1994, producing 500 billion rubles of revenue for the Treasury,[33] the Congress of the People's Deputies changed course. They decided to increase the share of distribution via vouchers to 85–90% of the assets, after allowing 51% rather than the originally targeted 30% for employee ownership.[34] This model of course is not known for generating particularly strong budget revenue; moreover, the actual implementability of the scheme in the time span proposed seems less than obvious. Whatever we think about the economic soundness of such a scheme, it seems

Communist Economies and Economic Transformation 1992.4:333-359.

hardly questionable that various target elements of these policies are not congruous.

This is not the place to speculate about the prospects of privatisation in Russia in the long run. In any case, according to press reports, in many rural areas people have not even heard of El'tsin's decree making it imperative to dissolve the *kolkhozy.* In large scale industry and in wholesale trade not too much has happened except for cases of *nomenklatura* privatisation, like previous Komsomol offices performing the role of commodity exchange or the ventures of the military–industrial complex in the Far East pre-empting actual conversion plans by their own initiative, by engaging in a large number of non-military-related economic activities. These developments, often deplored from the moral perspective, might explain to a great extent why the contraction of economic activity and the deterioration in living conditions has actually been less than could have been expected.

But let us confine our analysis to the Gaidar programme as a stabilisation package. It is a Moscow commonplace to mock the reformist government for overdoing the standard IMF prescriptions. One commentator notes in a typical tone that the wording of the Government's memorandum on joining the IMF is but re-translated into the original English.[35] While one can cite such remarks endlessly, the crux of the problem is that in Russia it is more or less *the reverse of the IMF stabilisation package which has been put into practice.* In a nutshell, an IMF programme boils down to a combination of fiscal and monetary restriction with foreign economic liberalisation. This is precisely what is not happening in Russia!

As far as fiscal and monetary restraint is concerned, Russian experts note bitterly[36] that republics have ceased to supply data on their cash balances, so that not even a formal federation-level cash balance could be drawn up for 1992. Monetary targets continued to be derived from the fiscal plan, while 14 monetary authorities emitted ruble-denominated credits and notes. As far as, for example, the Ukraine was concerned, given the level of development of the banking sector, there has not even been an attempt to measure the money supply quantitatively.[37] In Russia the parliament retained the monetary authority under its own control, so the expansionary policies of the Central Bank Governor, Matyukhin, gained continuous blessing, with reference to the need to avoid bankruptcies or help ailing sectors like agriculture. According to a report in the *Financial Times,*[38] the deficit in the first quarter in Russia alone was 25% of the budgetary outlays, which does not sound extremely restrictive. Lack of bankruptcy cases and marginal unemployment amidst a deep recession are indirect proof of our reasoning.

As far as foreign economic liberalisation was concerned, in the Russian declaration of joining the IMF[39] abolition of quotas and the introduction of a single rate of exchange are envisaged. In reality, the systems of licensing, quotas, prohibitions and other barriers even proliferated. To note but two: according to a decree of the Governor of the Bank of Russia[40] an additional 10% of convertible currency earnings of firms are taxed away (over and above the 'inherited' 40% foreign sales' tax). The list of commodities not to be sold abroad or subject to licensing was substantially lengthened in March and again in July 1992. The special exchange rate, applied for investment purposes only, seems to be a lasting element of Russian legislation. Last but not least, limitations on foreign ownership have been abolished only in the free trade zones.

Communist Economies and Economic Transformation 1992.4:333-359.

In sum, the two basic pillars of standard IMF policies do not seem to have been overdone in the January–July period either. When the Congress enforced the easing of monetary 'rigour', it declared the operation over before the major part of the surgery could even have been started.

There is thus very little room for us to believe that the supply side could and will adjust relatively quickly in Russia under the given policy mix. As the foundation of a stabilisation policy is a stable central power, which is not the case in El'tsin's Russia, we should not really be surprised at the outcome, and should certainly avoid blaming those who, everything notwithstanding, attempted to institute a change in the right direction. Our sympathy with the actors, however, should not overshadow the obvious warning signs. With the lack of institutionalised guarantees of proprietary rights, without the proper incentives to invest, with the ambiguous outcomes of stabilisation efforts, there is little hope of an increased propensity to save and invest. With the rudimentary state of markets, especially wholesale markets,[41] and the continued presence of bureaucratic superstructures, input-allocating and foreign trade monopolies, partial liberalisaton can deliver partial results only. True, high inflation will help to overcome the monetary overhang and mitigate the cost of a major readjustment which follows six or seven decades of price and structural distortions, at least in terms of bankruptcies and unemployment.

What might be a gain in terms of macroeconomic management could be a loss in terms of domestic demand for state assets. It remains to be seen whether artificial 'creation' of owners via radical populist privatisation schemes can really overcome those inherent constraints on property ownership, on the propensity to save and invest, which were discussed above. And constraints on human capital able to master market institutions are yet to be mentioned. The prospect for quick fixes is therefore dim.

Communist Economies and Economic Transformation 1992.4:333-359.

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Communist Economies and Economic Transformation 1992.4:333-359.

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Communist Economies and Economic Transformation 1992.4:333-359.